DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 02-0427
Indiana Individual Income Tax
For the Tax Year 2000

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ISSUES

I. Imposition of State's Individual Income Tax by Reference to Taxpayer's Federal Adjusted Gross Income.

Authority: Ind. Const. art. I, § 25; Ind. Const. art. IV, § 1; Ind. Const. art. X, § 8; IC 6-3-1-3.5; Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209 (Ind. Tax Ct. 1996); Ind. Dept. of Envtl. Management v. Chemical Waste Management, Inc., 643 N.E.2d 331 (Ind. 1994); Campbell v. Heiss, 53 N.E.2d 634 (Ind. 1944); Bissell Carpet Sweeper Co. v. Shane Co., 143 N.E.2d 415 (Ind. 1957); 45 IAC 3.1-1-1.

Taxpayer argues that because he reported "0" income on his Federal income tax return, he was compelled to report "0" income on his state return for that same year. In addition, taxpayer maintains that, under the Indiana Constitution, the state may not impose a state income tax by reference to the Federal Internal Revenue Code.

II. Imposition of the State's Individual Income Tax on Taxpayer's Wages.

Authority: Ind. Const. art. X, § 8; IC 6-3-1-3.5 et seq.; Butchers' Union Slaughter-House v. Crescent City Live-Stock, 111 U.S. 746 (1884); New York v. Graves, 300 U.S. 308 (1937); Merchant's Loan & Trust Co. v. Smietanka, 255 U.S. 509 (1921); Doyle v. Mitchell, 247 U.S. 179 (1918); United States v. Connor, 898 F2d 942 (3rd Cir. 1990); Wilcox v. Commissioner of Internal Revenue, 848 F2d 1007 (9th Cir. 1988); Coleman v. Commissioner of Internal Revenue, 791 F2d 68 (7th Cir. 1986); United States v. Koliboski, 732 F2d 1328 (7th Cir. 1984); United States v. Ballard, 535 F.2d 400 (8th Cir. 1976); United States v. Romero, 640 F2d 1014 (9th Cir. 1981); Snyder v. Indiana Dept. of State Revenue, 723 N.E.2d 487 (Ind. Tax Ct. 2000); Thomas v. Indiana Dept. of State Revenue, 675 N.E.2d 362 (Ind. Tax. Ct. 1997); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994).

Taxpayer argues that he did not receive taxable "income" because the exchange of labor for pay of equal value does not produce "income."

III. Payment of the Indiana Income Tax is Voluntary.

Authority: IC 6-8.1-11-2; Helvering v. Mitchell, 303 U.S. 391 (1938); United States v. Gerads, 999 F.2d 1255 (9th Cir. 1993); McLaughlin v. United States, 832 F.2d 986 (7th Cir. 1987); McKeown v. Ott, No. H 84-169, 1985 WL 11176 at *2 (N.D. Ind. Oct. 30, 1985).

Taxpayer maintains that payment of the state's income tax is entirely voluntary and that he no longer "volunteers" to pay state income tax.

IV. Sufficiency of Taxpayer's Indiana Tax Return.

Authority: 45 IAC 15-5-7; 45 IAC 15-5-7(f)(1).

Taxpayer argues that he fulfilled his obligations under the federal and state's adjusted gross income tax laws because he submitted a return which had been completed by writing a series of "zeroes."

STATEMENT OF FACTS

Taxpayer prepared and submitted an Indiana income tax return for 2000 in which he reported receiving "0" adjusted gross income. The Department of Revenue (Department) disagreed and subsequently sent taxpayer notices indicating that he owed unpaid state income taxes. Taxpayer answered the notices stating that the assessments were erroneous based upon various legal arguments. Taxpayer demanded the opportunity for a hearing during which he would have the opportunity to explain the basis for his protest. That opportunity was granted, and this Letter of Findings follows.

DISCUSSION

I. Imposition of State's Individual Income Tax by Reference to Taxpayer's Federal Adjusted Gross Income.

Taxpayer has set out numerous arguments challenging the legitimacy of the state's income tax scheme. Those arguments have been grouped into the four general sections set out in this Letter of Findings. Taxpayer's first arguments challenge generally the legitimacy of the state's practice of referencing the federal rules in interpreting and applying the state's own tax laws.

A. Delegation of State Legislative Authority.

Taxpayer argues that, "Nowhere in the Indiana Constitution did the people of this state give any power to the federal government to make laws exclusively for those living in

Indiana." In effect, taxpayer argues that the Indiana Constitution does not permit references to another taxing jurisdiction's own laws and when faced with such an improper reference – such as that found within IC 6-3-1-3.5 – the taxpayer's compliance is not required.

Specifically, taxpayer cites to Ind. Const. art. I, § 25 which states that, "No law shall be passed, the taking effect of which shall be made to depend upon any authority, except as provided in this Constitution." This section of the state constitution is intended to place a limit on "the legislative activity of the General Assembly." Ind. Dept. of Envtl. Management v. Chemical Waste Management, Inc., 643 N.E.2d 331, 341 (Ind. 1994).

The Indiana Constitution vests all legislative authority in the Indiana General Assembly. "The Legislative authority of the State shall be vested in a General Assembly, which shall consist of a Senate and a House of Representatives. The style of every law shall be: 'Be it enacted by the General Assembly of the State of Indiana': and no law shall be enacted, except by bill." Ind. Const. art. IV, § 1. Taxpayer is correct in his assertion that, under Ind. Const. art. I, § 25 and art. IV, § 1, the Indiana General Assembly may not delegate either its authority or its responsibility for performing its exclusively legislative functions. "The power to legislate or to exercise a legislative function cannot be delegated to a non-governmental agency or person. Nor can the Legislature delegate its law-making power to a governmental officer, board, bureau or commission." Bissell Carpet Sweeper Co. v. Shane Co., 143 N.E.2d 415, 419 (Ind. 1957) (Internal citations omitted).

On its face, taxpayer's contention appears to have merit. The Indiana General Assembly may not delegate its responsibility for defining the state's adjusted gross income tax scheme to the federal government. Neither may the Assembly's authority to implement such a scheme be obtained under federal law. However, the cross-references to the Internal Revenue Code – such as I.R.C. § 62 cited within IC 6-3-1-3.5 – does not delegate any such authority. The state legislature did not turn over its authority to the federal government. The state legislature did not obtain its authority from the federal government. Ind. Const. art. X, § 8 unambiguously states that, "The general assembly may levy and collect a tax upon income from whatever source derived . . . ." The Indiana Code provisions reflect merely the legislature's considered and independent decision to employ the federal calculation as the starting point for determining Indiana's adjusted gross income tax. "It is well settled that a legislative body may enact a law, the operation of which depends upon the existence of a stipulated condition." Campbell v. Heiss, 53 N.E.2d 634, 636 (Ind. 1944). The state legislature has retained its independent authority to define and enforce the state's own income tax plan. That the Indiana General Assembly has retained authority to stake out the parameters of the state's adjusted gross income tax scheme is evidenced by the Assembly's decisions to periodically reenact IC 6-3-1-3.5 the latest of which occurred in 2001. Whether the General Assembly should have avoided internal references to the Internal Revenue Code by independently drafting original statutory provisions mirroring the Internal Revenue Code and then require every Indiana taxpayer to recalculate his taxable income, is an issue beyond the scope of this Letter of Findings and irrelevant to determining taxpayer's tax liability. Suffice it to say

that the General Assembly acted entirely within its authority in employing the federal adjusted gross income as the jumping off point for calculating the individual taxpayer's Indiana adjusted gross income.

B. Taxpayer's Reported Federal Income Tax.

Taxpayer makes a somewhat related argument. Taxpayer argues that he accurately reported his income by placing "zeroes" on his state tax return. Taxpayer bases this argument by stating that he had no legal alternative because he had also placed "zeroes" on his federal return. Taxpayer rhetorically asks, "Should I have perjured myself and claimed that I reported something other than the 'zeroes' I reported on my Federal tax returns for my Gross Income."

A copy of taxpayer's federal income tax return indicates that taxpayer did indeed fill out the form by placing numerous zeroes on that form. It is undisputed that the Indiana tax return for the tax year 2000 employs federal adjusted gross income as the starting point for determining the taxpayer's state individual income tax liability. Line one of the IT-40 form requires the taxpayer to "Enter your federal adjusted gross income from your federal return (see page 9)."

IC 6-3-1-3.5 states as follows: "When used in IC 6-3, the term 'adjusted gross income' shall mean the following: (a) In the case of all individuals 'adjusted gross income' (as defined in Section 62 of the Internal Revenue Code) . . . ." Thereafter, the statute proceeds to delineate specific addbacks and deductions, peculiar to Indiana, which modify the federal adjusted gross income amount. The Department's regulation concisely restates the same formulary principal. 45 IAC 3.1-1-1 defines individual adjusted gross income as follows:

> Adjusted Gross Income for Individuals Defined. For individuals, "Adjusted Gross Income" is "Adjusted Gross Income as defined in Internal Revenue Code § 62 modified as follows:
>
> > (1) Begin with gross income as defined in section 61 of the Internal Revenue Code.
> > (2) Subtract any deductions allowed by section 62 of the Internal Revenue Code.
> > (3) Make all modifications required by IC 6-3-1-3.5(a).

Both the statute, IC 6-3-1-3.5, and the accompanying regulation, 45 IAC 3.1-1-1, require that an Indiana taxpayer employ the federal adjusted gross income calculation, as determined under I.R.C. § 62, as the starting point for determining that taxpayer's Indiana adjusted gross income.

Taxpayer's contention – that he was compelled by force of law to declare "0" as Indiana adjusted gross income because he declared "0" on his federal return – is patently without merit. The statute is plain and unambiguous. Indiana adjusted gross income begins with

federal taxable income as defined by I.R.C. § 62, not as reported by the taxpayer. *See* Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209, 1213 (Ind. Tax Ct. 1996). The directions contained within the Indiana income tax form provide the individual taxpayer with abbreviated directions for completing the form and not the means for determining the taxpayer's adjusted gross income. The Indiana tax form instructs the taxpayer to put what number in what box. Those directions notwithstanding, taxpayer is nonetheless required to actually perform the calculations necessary to determine his liability for Indiana adjusted gross income tax.

FINDING

Taxpayer's protest is denied.

II. Imposition of the State's Individual Income Tax on Taxpayer's Wages.

Taxpayer's next argument is that he did not receive any "income" because he only exchanged his labor – one form of property – for money – another form of property. Therefore, because taxpayer did not receive any "gain" but merely a "like-kind" exchange, he received no taxable income.

In support of this proposition, taxpayer cites to Butchers' Union Slaughter-House v. Crescent City Live-Stock, 111 U.S. 746, 757 (1884), which states in part:

> The property which every man has in his own labor, as it is the original foundation of all other property, so it is the most sacred and inviolable . . . to hinder his employing this strength and dexterity in what manner he thinks proper, without injury to his neighbor, is a plain violation of this most sacred property.

Taxpayer's exact legal proposition is somewhat ambiguous; however, the argument seems to be that the government – by means of an income tax scheme – may not interfere with the individual citizen's right to exchange his labor for wages and that the wages he receives do not constitute "income." Liberally construed, taxpayer's argument is that – for purposes of determining income tax liability – "income" can only be derivative of corporate activity. Therefore, as an individual Indiana resident who by definition did not receive "corporate" income, taxpayer is not subject to the state's adjusted gross income tax.

In support of that proposition, taxpayer cites to a number of Supreme Court cases including Doyle v. Mitchell, 247 U.S. 179 (1918); Merchant's Loan & Trust Co. v. Smietanka, 255 U.S. 509 (1921); and a federal circuit court case, United States v. Ballard, 535 F.2d 400 (8th Cir. 1976).

In Doyle, the Court stated that "Whatever difficulty there may be about a precise and scientific definition of 'income' it imports . . . the idea of gain or increase arising from corporate activities." Doyle at 185. In Smietanka, the Court stated that, "There can be no doubt that the word [income] must be given the same meaning and content in the Income

Tax Acts of 1916 and 1917 that it had in the Act of 1913." Smietanka at 519. Similarly, the same Court stated, "there would seem to be no room to doubt that the word must be given the same meaning in all of the Income Tax Acts of Congress that was given to it in the Corporation Excise Tax Act and that what that meaning is has now become definitely settled by decisions of this court." Id. Taxpayer reads these and the cited companion cases as supporting the proposition that the federal income tax – and by extension Indiana's adjusted gross income tax – can only be levied against corporate gain. According to taxpayer, the cases inevitably lead to the conclusion that "income" – as referred to within both the federal and companion state statutes – is exclusively limited to that definition as established under the Civil War Income Tax Act of 1867; the Corporation Excise Tax Act of 1909; and the Income Tax Acts of 1913, 1916, and 1917.

However, the cited cases do not permit such a conclusion. In the cases cited by taxpayer, the Court was asked to determine the definition of corporate income. In Doyle, the Supreme Court was asked to resolve the issue of whether the increase in value of the corporate taxpayer's standing timber constituted "income." In determining that the increase in value did not constitute corporate "income," the Court stated that the definition of corporate income had remained unchanged during the intervening recodifications of the federal corporate income tax and the ratification of the Sixteenth Amendment to the United States Constitution. In Smietanka – resolving the issue of whether a provision in a will, stipulating that accretions in the value of testamentary property should be considered additions to principal and not income – the court similarly noted that the definition of "income" had remained unchanged. The Court went on to state that. "In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. . . ." Smietanka at 519.

The cited cases support the proposition that corporate gain is subject to the existing federal corporate income tax scheme. The cited cases do nothing to support the assertion that *only* corporate gain is subject to the tax. Simply stated, if the courts are asked to define "corporate income," the courts will arrive at a conclusion which defines "corporate income."

In United States v. Ballard, 535 F.2d 400 (8th Cir. 1976), the court stated, in determining appellant taxpayer's individual income tax liability, that, "The general term "income" is not defined in the Internal Revenue Code." Id. at 404. Rather, the court noted that the Internal Revenue Code operates under and employs the term "gross income." Id. However, nothing in Ballard can be read to support the proposition that the federal adjusted gross income tax is only applicable to corporate gain or that individual taxpayer's wages are not subject to imposition of the federal adjusted gross income tax. To the contrary, the court found that appellant taxpayer was liable for additional income taxes on wages received from his business. Id. at 405.

The question of what constitutes individual taxable "income" has been answered by the courts. Although not binding upon Indiana's decision to tax the wages of its own citizens, the United States Supreme Court has definitively ruled on the question of whether a

citizen's individual income may be subjected to an adjusted gross income tax. In New York v. Graves, 300 U.S. 308, 312-13 (1937), Justice Stone stated as follows:

> That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil itself affords a basis for such taxation. Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from the responsibility for sharing the costs of government . . . . A tax measured by the net income of residents is an equitable method of distributing the burdens of government among those who are privileged to enjoy its benefits. The tax, which is apportioned to the ability of the taxpayer to pay it, is founded upon the protection afforded by the state to the recipient of the income in his person, in his right to receive the income and in his enjoyment of it when received. These are rights and privileges which attach to domicil within the state. To them and to the equitable distribution of the tax burden, the economic advantage realized by the receipt of income and represented by the power to control it, bears a direct relationship. *Neither the privilege nor the burden is affected by the character of the source from which the income is derived.* (*Emphasis added*).

Since that 1937 decision, the federal courts have consistently, repeatedly, and without exception determined that individual wages – no matter in what form the taxpayers have attempted to characterize, define, or label those wages – are income subject to taxation. United States v. Connor, 898 F2d 942. 943 (3rd Cir. 1990) ("Every court which has ever considered the issue has unequivocally rejected the argument that wages are not income"); Wilcox v. Commissioner of Internal Revenue, 848 F2d 1007, 1008 (9th Cir. 1988) ("First, wages are income."); Coleman v. Commissioner of Internal Revenue, 791 F2d 68, 70 (7th Cir. 1986) ("Wages are income, and the tax on wages is constitutional."); United States v. Koliboski, 732 F2d 1328, 1329 n. 1 (7th Cir. 1984) ("Let us now put [the question] to rest: WAGES ARE INCOME. Any reading of tax cases by would-be tax protesters now should preclude a claim of good-faith belief that wages – or salaries – are not taxable.") (Emphasis in original); United States v. Romero, 640 F2d 1014, 1016 (9th Cir. 1981) ("Compensation for labor or services, paid in the form of wages or salary, has been universally held by the courts of this republic to be income, subject to the income tax laws currently applicable. . . . [Taxpayers] seems to have been inspired by various tax protesting groups across the land who postulate weird and illogical theories of tax avoidance all to the detriment of the common weal [sic] and of themselves.").

In addressing the identical question, the Indiana Tax Court has held that, "Common definition, an overwhelming body of case law by the United Sates Supreme Court and federal circuit courts, and this Court's opinion . . . all support the conclusion that wages are income for purposes of Indiana's adjusted gross income tax." Snyder v. Indiana Dept. of State Revenue, 723 N.E.2d 487, 491 (Ind. Tax Ct. 2000). *See also* Thomas v. Indiana Dept. of State Revenue, 675 N.E.2d 362 (Ind. Tax Ct. 1997); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994).

Taxpayers' distinctions aside, taxpayer's income – by whatever linguistic device the taxpayer may wish to characterize that income – is subject to Indiana's adjusted gross income tax as defined by the General Assembly under IC 6-3-1-3.5 et seq. and as authorized by the Indiana Constitution. Ind. Const. art X, § 8.

FINDING

Taxpayer's protest is denied.

III. Payment of the Indiana Income Tax is Voluntary.

Taxpayer argues that payment of Indiana individual income tax is voluntary and that he no longer volunteers to pay the tax. Taxpayer cites to IC 6-8.1-11-2 which states as follows:

> The general assembly makes the following findings: (3) The Indiana tax system is based largely on *voluntary compliance*. (4) The development of understandable tax laws and the education of taxpayers concerning the tax laws will improve *voluntary compliance* and the relationship between the state and taxpayers. (*Emphasis added*).

Taxpayer's argument is without merit. In describing the nature of the federal tax system, the Court has stated that, "In assessing income taxes the Government relies primarily upon the disclosure by the taxpayer of the relevant facts. This disclosure it requires him to make in his annual return. To ensure full and honest disclosure, to discourage fraudulent attempts to evade the tax, Congress imposes sanctions. Such sanctions may confessedly be either criminal or civil." Helvering v. Mitchell, 303 U.S. 391, 399 (1938).

Taxpayer's basic contention – that Indiana depends on its citizens' voluntary compliance with the tax laws – is undeniable. Indeed, the state also depends on its licensed drivers to drive on the right side of the road. However, that does not mean that failure to comply with the law is without predictable consequences. "Any assertion that the payment of income taxes is voluntary is without merit. It is without question that the payment of income taxes is not voluntary." United States v. Gerads, 999 F.2d 1255, 1256 (9th Cir. 1993). "The notion that the federal income tax is contractual or otherwise consensual in nature is not only utterly without foundation, but despite [appellant's] protestation to the contrary, has been repeatedly rejected by the courts." McLaughlin v. United States, 832 F.2d 986, 987 (7th Cir. 1987). "[A]rguments about who is a 'person' under the tax laws, the assertion that 'wages are not income', and maintaining that *payment of taxes is a purely voluntary function do not comport with common sense - let alone the law.*" McKeown v. Ott, No. H 84-169, 1985 WL 11176 at *2 (N.D. Ind. Oct. 30, 1985) (Emphasis Added). Such arguments "have been clearly and repeatedly rejected by this and every other court to review them." Id. at *1.

FINDING

Taxpayer's protest is denied.

IV. Sufficiency of Taxpayer's Indiana Tax Return.

Taxpayer points out that filled out his IT-40 income tax return with numerous "zeroes" and that by filling in the paper with "zeroes" he has fulfilled his obligations as a resident of the state. In support of this proposition, taxpayer cites to 45 IAC 15-5-7 which states in part that, "Any denotion by the taxpayer which clearly indicates a positive denial of liability for any tax listed on the tax form shall constitute a completed return. Thus, a return which has 'zero,' or '0' or 'none' written on a given line is not substantially blank." 45 IAC 15-5-7(f)(1).

Taxpayer makes a jaw-dropping leap of logic. The regulation which taxpayer cites relates to "the statute of limitations for the assessment of a listed tax liability . . . ." 45 IAC 15-5-7(a) and has nothing whatsoever to do with whether taxpayer is responsible for paying Indiana income tax during the year 2000. The Department does not contend that taxpayer failed to send in his 2000 return. The Department does not disagree that, for purposes of taxpayer's 2000 return, the three-year statute of limitations specified under 45 IAC 15-5-7 began to run "from the due date of the annual return . . . or the date on which the annual return [was] filed."

Taxpayer's contention – that he has fulfilled his obligations under the state's tax laws and his shared obligations to the citizens of this state by filling out a piece of paper with "zeroes" – is frivolous.

FINDING

Taxpayer's protest is denied.

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